ROBERT E. HERZSTEIN*

The Need to Reform Section 592 of the Tariff Act of 1930†

Section 592 of the Tariff Act of 1930, 19 U.S.C. § 1592, imposes penalties for erroneous statements to the Customs Service in connection with the importation of merchandise. The penalty imposed may be excessive in amount and may bear no reasonable relationship to the offense which has been committed. Further, penalties are imposed by the Customs Service without rudimentary due process protections and without adequate opportunities for meaningful judicial review. The penalties may arguably be penal in nature, and thus the Constitution may require that those accused of violating section 592 are entitled to the protections afforded in criminal prosecutions.

Because of the draconian nature of the sanctions under section 592 and the absence of adequate procedural due process and judicial review with respect to administration of this section, legislative reform of the section is necessary to bring it into accord with current notions of fairness and to take into account the legitimate interests and concerns of persons who must conduct their businesses subject to the strictures of the statute.

I. The Provisions of Section 592 and Related Statutes

Section 592 makes it unlawful for any person to import or attempt to import merchandise into the United States "by means of any fraudulent or false invoice, declaration, affidavit, letter, paper, or by means of any false statement, written or verbal, or by means of any false or fraudulent practice or appliance," unless

*LL.B. Harvard Law School 1955. Currently with the law firm of Arnold & Porter; Co-Chairman of the International Law Section's Committee on Tariffs, Customs, the GATT and Regional Trade Agreements; Vice Chairman of the American Society of International Law's Panel on International Trade Policy and Institutions.

†This Article is in large part drawn from a memorandum prepared by the Committee on Tariffs, Customs, the GATT and Regional Trade Agreements of the Section of International Law of which Mr. Herzstein is Co-Chairman. The memorandum was prepared as an information report in the course of the Committee's study of section 592 which resulted in the adoption of a resolution by the American Bar Association's House of Delegates in August 1975.

Many persons contributed to the memorandum. The author wishes especially to recognize the contributions made by Stephen L. Gibson, Brooksley Landau, Daniel Lewis and Patrick Macrory.

that person has "reasonable cause to believe the truth of such statement." The statutory penalty is forfeiture of the merchandise itself or a fine equal to its domestic value. By its terms the statute applies even where the false statement would not result in an underpayment of duty, and the term "false statement" is considered by the Customs Service to embrace negligent as well as intentional statements.[1]

The penalty under section 592 is generally administratively assessed by the Customs Service. The Customs Service does have administrative discretion to mitigate the penalty. 19 U.S.C. § 1618 gives the Secretary of the Treasury authority to mitigate forfeitures and penalties under various statutes, including section 592, "upon such terms and conditions as he deems just and reasonable," and in the case of section 592 this authority has been delegated to the Commissioner of Customs.[2] In most cases the penalty is mitigated to some multiple (generally between two and ten) of the duty underpayment resulting from the erroneous statement.

If the importer refuses to pay a penalty (whether or not mitigated), section 592 may be enforced in an action commenced by the United States in a U.S. district court. Once the United States has established "probable cause" to believe that a violation of the statute has occurred—a task which can be accomplished simply by demonstrating an error in the entry documents[3]—the burden of proof is placed on the respondent to show that in fact a violation has not occurred.[4] 19 U.S.C. § 1615.

In addition to the section 592 penalty, criminal liability for entry of goods by means of false statements may be imposed under 18 U.S.C. § 542, which is similar in terms to section 592.

II. The Penalty Imposed Under Section 592 May Bear No Relationship to the Nature of the Offense

The amount of the potential penalty under section 592 is excessive. The only statutory limitation on the penalty is the U.S. value of the merchandise covered by the false statement, which may of course run to many thousands of dollars. Accordingly, the sanctions available under this civil penalty statute can far

---

[1]For reasons explained below, very few section 592 proceedings reach the courts, so that there has been little opportunity to test this interpretation. In Jen Dao Chen v. United States, 385 F.2d 939 (9th Cir. 1967), the United States Court of Appeals for the Ninth Circuit held that intent to defraud was required under section 592. However, this holding was in effect overruled a few years later in United States v. Wagner, 434 F.2d 627 (9th Cir. 1970), in which the court said that the term "intent" as used in *Jen Dao Chen* must be equated with the "reasonable cause to believe" language in section 592. *See also* Kohner v. Wechsler, 477 F.2d 666, 673 n. 12 (2d Cir. 1973) (*concurring opinion of* Timbers, J.).

[2]The District Directors of Customs have authority to mitigate causes where the forfeiture value is $25,000 or less. 19 C.F.R. § 171.21. All other cases must be sent to Customs Headquarters in Washington for final decision.

[3]*See, e.g.*, United States v. Nephrite Jade, 325 F. Supp. 986, 989 (W.D. Mo. 1970).

[4]*See, e.g.*, United States v. Alcatex, Inc., 328 F. Supp. 129, 134 (S.D.N.Y. 1971).

exceed the penalties normally found in criminal statutes, even for felonies. It is particularly anomalous that the penalty which may be imposed under section 592 may easily exceed the maximum $5,000 fine that can be imposed for a criminal conviction under 18 U.S.C. § 542, where the standards of proof that prevail are much stricter than in the forfeiture action.

Further, the sanctions imposed by section 592 are in most cases out of all proportion to the seriousness of the offense. When penalties are established for most legal infractions—by the legislature or the courts—careful consideration is customarily given to the degree of culpability of the offender and to the consequences of his offense. However, in section 592 cases there is no predictable correlation between the value of goods in a given shipment and the culpability of the importer responsible for an error in the entry papers or the amount of duty underpaid.

Thus, under section 592 a $10 million dollar aircraft could be forfeited for false statements that resulted from mere negligence and produced a duty underpayment of a few hundred dollars. The value of shipments entered over a period of months or years and amounting to tens of millions of dollars could be forfeited upon discovery of errors resulting from negligence of an importer's clerical personnel, even though they produced relatively small duty underpayments. In a recent proceeding which attracted wide attention, a penalty notice was issued to Standard-Kollsman, Inc., an electronics manufacturer, claiming a penalty of some $42.5 million. The duty underpayment which gave rise to the penalty proceeding was reported to be around $115,000, *i.e.*, about 0.3 percent of the penalty asserted.[5]

Although statutory penalties are frequently mitigated by the Customs Service, the mere issuance of a penalty notice of such magnitude creates an extraordinarily serious problem for the firm receiving it. Publicly-held companies must disclose contingent liabilities of this kind, and any company attempting to obtain financing would have to reveal the contingent liability in its financial statements. It is almost certainly no coincidence that the publicly-quoted price of Standard-Kollsman's stock dropped by 20 percent in the four weeks following the issuance of the penalty notice, but recovered most of this on the day after the penalty had been mitigated to $1.65 million.

The unreasonableness and excessiveness of the sanctions under section 592 are particularly clear when they are imposed upon a person who is innocent of any

---

[5]*See* Form 8-K for period ending December 31, 1972, filed by Standard-Kollsman, Inc., with the Securities and Exchange Commission. It is interesting to note that if Standard-Kollsman had underpaid its taxes by $115,000, the highest civil penalty that could have been assessed against it would have been $57,500, if the underpayment had been deliberate, or $5,750, if it had been negligent. *See* 26 U.S.C. § 6653(a) and (b).

It has also been reported that a company was assessed a $10,000 penalty in connection with a clerical error in currency conversion which resulted in a $36 duty underpayment. Letter from Electronic Industries Association to Hon. Wilbur D. Mills, Sept. 27, 1973.

wrongdoing or has been merely negligent. As stated above, the Customs Service has taken the position that a penalty may be imposed on a person who made a false statement because of negligence. Further, forfeiture of goods in the possession of a wholly innocent importer may be authorized by the statute.

The excessive size of the penalty and its lack of any reasonable relationship to the state of mind of the violator or to the amount of harm caused by the violation raise substantial issues under the Due Process Clause of the Fifth Amendment—the violator may arguably be arbitrarily and capriciously deprived of his property. Further, it might be argued that section 592 permits unreasonable seizures of property in violation of the Fourth Amendment's prohibition against unreasonable searches and seizures or involves the imposition of an excessive fine in violation of the provisions of the Eighth Amendment.

In addition, the penalties imposed under section 592 would seen to contravene the policy expressed in a provision of the General Agreement on Tariffs and Trade:

> No contracting party shall impose substantial penalties for minor breaches of customs regulations or procedural requirements. In particular, no penalty in respect of any omission or mistake in customs documentation which is easily rectifiable and obviously made without fraudulent intent or gross negligence shall be greater than necessary to serve merely as a warning. Art. VIII(3).

The GATT does not commit the United States to action inconsistent with prior legislation.[6] Since section 592 was a United States law prior to the United States undertaking to apply the provisions of GATT, it has not been superceded by this GATT provision. However, since section 592 is vague and extremely broad, it might be argued that section 592 should be construed, in light of this provision of the GATT, to apply only to false statements made intentionally or recklessly.

III. The Customs Service Procedures for Assessing a Penalty Pursuant to Section 592 Do Not Provide Due Process Protections to the Alleged Violator

Penalties have been assessed and seizures have been made by Customs under section 592 without procedural protections normally associated with due process. There has generally been no adequate notice given of the facts upon which Customs bases its conclusion that a penalty or forfeiture has been incurred, no hearing before an impartial hearing examiner, no right of cross-examination of adverse witnesses, and no final determination with findings of fact and statements of the reasons for the decision.

The penalty notices are usually prepared by junior officials in the Customs Service, who may have little appreciation of the serious financial consequences that may follow the mere issuance of a notice, and often have received no more

[6]Protocol of Provisional Application of the General Agreement of Tariffs and Trade, ¶ 1(b).

than a cursory review by the District Director before being issued.[7] The notice is usually extremely brief and conclusive in nature, and requests for additional information in the past have rarely produced useful results.

Once a penalty notice has been issued, Customs officials at the local level may be reluctant to revoke it, even though the subsequently developed facts indicate that the statute has not been violated. Having put the respondent to the time and expense of investigating the facts and preparing a petition for mitigatior they may be reluctant to admit that the notice may have been issued in error, and the temptation to pass the matter on to Customs Headquarters in Washington for final decision is very strong.

Of course, Customs Headquarters relies heavily on the factual findings and recommendations of the local officials in reaching its decision. Determinations of liability apparently are made by Customs principally on the basis of information developed by Customs agents during their field investigation. The results of that investigation have not customarily been made available to the person receiving the penalty notice. Because of the absence of due process procedures, efforts to contest penalty assessment under section 592 generally have taken the form of negotiation between the alleged violator and the Service, rather than adjudicatory fact-finding process.

A recent action by the Customs Service may provide some procedural rights to the importer. On January 16, 1975, the Service published new regulations which provide that, prior to issuing a penalty notice, the District Director must in most circumstances notify the importer of his intention to issue such notice and must describe the merchandise involved, the provisions of law violated and the acts or omissions constituting the violation. The importer may reply to such notice in writing within 30 days "either refuting the allegations or establishing that reasonable cause existed for believing that the acts or omissions described in the allegations were proper." 40 Fed. Reg. 2797-98 (Jan. 16, 1975). In addition the District Director may permit oral argument. The District Director must consider the reply of the importer, determine whether it disproves the claim and either notify the importer that a penalty notice will not issue or issue the penalty notice.

The degree of relief to be obtained by the importers from this prepenalty-notice procedure depends in great part on how it is implemented: the specificity of the notice provided, the frequency with which hearings are held, etc. In any event, the procedure will not provide a hearing as a matter of right before an impartial decision maker nor will it require a determination based on findings of fact and conclusions of law.

---

[7]Moreover, it seems that in some cases penalty notices may have been issued even where the Customs officials do not have reason to believe that section 592 was violated, simply as a convenient means of correcting nonculpable errors. Customs Service officials cite the case of a District Director who issued a penalty notice against an importer who was complying with a Customs Service ruling which he had received but which the District Director considered erroneous.

Where a seizure is involved, the alleged violator is at the mercy of the Customs Service. Seizure can be and is made upon suspicion of a section 592 violation, even before the penalty notice is issued, and unless the claimant is willing to pre-pay the penalty, the goods remain under seizure until the Service makes its final determination on the amount of penalty it will impose.[8]

IV. Procedures Followed by the Customs Service with Respect to Mitigation of a Penalty Also Lack Adequate Safeguards for the Petitioner

A person receiving a penalty notice may petition the Customs Service for mitigation or remission of the penalty. The proceedings relating to such petition are informal and discretionary with the Service. No provision is made for a hearing, nor has the petitioner generally been afforded any additional information relating to the reasons for the imposition of the penalty.[9] The Customs Service does not give reasons for its decision whether to mitigate, nor does it make factual findings on which it bases its decision.

The Service has recently taken a step in the right direction by publishing standards relating to mitigation. 39 Fed. Reg. 39061 (Nov. 5, 1974); 40 Fed. Reg. 2797 (Jan. 16, 1975). Previously, a petitioner had little means of determining what information would be relevant to the mitigation determination. Now the published guidelines indicate that the usual mitigated penalty consists of a multiple of the duty underpayment and that the multiple varies according to the state of mind of the violator. But the Customs Service has still refused to disclose the multiples actually used by it.

V. Judicial Review of the Customs Service's Decision is Inadequate

The sole method for obtaining judicial review of a penalty to date has been for the person who has been penalized to refuse to pay the penalty.[10] In such a

[8] *See* 19 C.F.R. §§ 162.21, 162,41, 162.44. Under 19 C.F.R. § 162.44 the Commissioner of Customs or a District Director may release the seized property to the claimant provided that the claimant pays to Customs the appraised domestic value of the seized property. Under an unpublished administrative rule, Customs has modified the regulation to permit the claimant to obtain release of the property upon payment of a multiple of lost revenues which is set by the Service on a case-by-case basis.

[9] An ORR Ruling, 74-0203 (Sept. 26, 1974), provides that "attorneys should be furnished with specific information necessary to enable them to prepare petitions for relief. . . ." Whether this ruling will in practice result in sufficient notice to the petitioner is not yet clear.

[10] In a case filed in 1974 an importer which paid mitigated penalties after negotiations with Customs is attempting to obtain judicial review of the imposition of the penalty and a declaratory judgment that section 592 is unconstitutional. BSR Ltd. v. Morgan, Civ. No. 74-2246, S.D.N.Y., filed May 23, 1974. The government however filed a counterclaim for the full amount of the statutory penalty. If the government is allowed to press its counterclaim, even the declaratory judgment route for seeking judicial review of the constitutionality of the statute would be precluded except to a party willing to risk having to pay the full statutory penalty.

situation the United States has had to bring an enforcement action in a district court.

In an enforcement action the court will only determine whether section 592 has been violated. It will refuse to review the Service's mitigation decision.[11] *See, e.g., United States v. One 1970 Buick Riviera*, 463 F.2d 1168 (5th Cir. 1972), *cert. denied*, 409 U.S. 980 (1972); *United States v. One 1961 Cadillac*, 337 F.2d 730 (6th Cir. 1964). This refusal to review the administrative procedures is probably erroneous and certainly deprives the person penalized of effective review of government action substantially harming him. One of the leading authorities on administrative law has concluded, after a careful review of the mitigation powers conferred by 19 U.S.C. § 1618, that:

> A reviewing court, without at any point substituting judgment, could (a) determine the reasonableness of the rules developed by the administrator as a guide to discretion, (b) require that those rules be open to public inspection, (c) ascertain whether the particular exercise of discretion arbitrarily departs from the administrative case law, (d) require that the administrative case law be open to public inspection in compliance with § 3(b) of the Administrative Procedure Act, (e) require findings of fact and a statement of reasons, (f) determine whether the findings are supported by substantial evidence, (g) determine whether the stated reasons are based upon considerations which are reasonable and legal![12]

In an enforcement action the person penalized loses the benefit of any mitigation which may have been administratively granted. The court has no discretion under the statute to mitigate the amount of the penalty (the full U.S. value of the goods), and the Customs Service refuses to mitigate if a case goes to trial.[13]

In the case of Standard-Kollsman, described above, the Customs Service agreed to mitigate a $42.5 million penalty to $1.65 million. If Standard-Kollsman had wished to challenge the Customs Service's determination that section 592 had been violated, it would have had to take into consideration the fact that the consequence of losing in court would have been, not a $1.65 million penalty, but the full original assessment of $42.5 million. Given the breadth of the statute and the fact that the burden of proof in a section 592 proceeding is on the respondent, it is clear that the respondent cannot afford to take the case to court unless he is confident of winning. Even an estimated 95 percent chance of success would hardly justify risking a penalty of $42.5 million.

---

[11]However, a decision by the Secretary of the Treasury that he has no power to act under the mitigation statute is reviewable. Cotonificio Bustese, S.A. v. Morganthau, 121 F.2d 884 (D.C. Cir. 1941). *Cf.* United States v. United States Coin & Currency, 401 U.S. 715, 721 (1971).

[12]DAVIS, ADMINISTRATIVE LAW 981-982 (1970 Supp.). *Cf.* Wong Wing Hang v. Immigration and Naturalization Service, 360 F.2d 715, 718-719 (2d Cir. 1966).

[13]In an unreported decision, Andean Credit, S.A. v. United States (Case No. 73-1294-CIV-WM, December 10, 1973), the United States District Court for the Southern District of Florida refused to order forfeiture of a yacht valued at over $1 million, which it stated would be "so severe a penalty as to be shocking to the conscience of this Court." The court instead ordered payment of the unpaid duties, which amounted to $60,000. The court's reasoning was rather unclear, but its result shows a reluctance to assess the full amount of the statutorily required penalty.

Thus, in order to obtain judicial review of a penalty, the person penalized must forego the mitigation of a penalty which is in all probability excessive and unrelated to the offense involved. One might well argue that this requirement placed an unconstitutional burden on the right to judicial review.

The situation is analogous to a procedure whereby a criminal defendant could only appeal from conviction upon pain of receiving the maximum sentence, instead of that imposed by the trial court, if he does not prevail. Such a requirement would clearly be unconstitutional. *See, e.g., North Carolina v. Pearce,* 395 U.S. 711, 724 (1969), in which the Supreme Court said:

> A court is without right to . . . put a price on an appeal. A defendant's exercise of a right of appeal must be free and unfettered. . . . [I]t is unfair to use the great power given to the court to determine sentence to place the defendant in the dilemma of making an unfree choice.[14]

The Supreme Court faced a somewhat similar situation in *Ex parte Young,* 209 U.S. 123 (1908). There a railroad company challenged the constitutionality of a Minnesota statute which imposed heavy fines and possible imprisonment for failure to charge the rates established by a state commission. The Court held that the enforcement provisions of the act were "unconstitutional on their face," 209 U.S. at 148, since they effectively prevented judicial review of the validity of the ratemaking power. The court further stated:

> It may therefore be said that when the penalties for disobedience are by fines so enormous and imprisonment so severe as to intimidate the company and its officers from resorting to the courts to test the validity of the legislation, the result is the same as if the law in its terms prohibited the company from seeking judicial construction of laws which deeply affect its rights. . . .
>
> Now, to impose upon a party interested the burden of obtaining a judicial decision of such a question (no prior hearing having ever been given) only upon the condition that if unsuccessful he must suffer imprisonment and pay fines as provided in these acts, is, in effect, to close up all approaches to the courts, and thus prevent any hearing upon the question whether the rates as provided by the acts are not too low, and therefore invalid. 209 U.S. at 147-48.

As mentioned above, a further inadequacy relating to judicial review is that the burden of proof in an enforcement action is on the respondent rather than the government. Thus, even in court the government need not justify in detail its imposition of the penalty.

VI. If the Penalty Were Determined to be Penal in Nature, the Person Penalized Would Be Entitled to Additional Protections

In light of the excessive and obviously punitive nature of the penalties imposed under section 592 it might be argued that they are penal in nature and thus that the person penalized is entitled to the protections accorded a criminal defendant

[14] *Cf.* James v. Strange, 407 U.S. 128, 142 (1972); Rinaldi v. Yeager, 384 U.S. 305, 310 (1966).

under the Bill of Rights. It may be difficult to prevail on such an argument since the Supreme Court has recognized the criminal nature of certain civil penalties only in a very narrow range of cases such as the cases involving deprivation of citizenship.

Nevertheless, it is useful to review the protections afforded in a criminal prosecution which are lacking with respect to section 592. Such a review is especially revealing in light of the fact that in a proceeding under the applicable criminal statute, 18 U.S.C. § 542, on the same facts and resulting in a smaller fine than a section 592 proceeding, the defendant would be entitled to such protections.

Rights granted to a criminal defendant but denied to a person penalized pursuant to section 592 include the presumption of innocence, the right to remain silent, the right to indictment by a grand jury, and the application of double jeopardy rules.

VII. Reform of Section 592

Legislative reform of section 592 is imperative to assure reasonable sanctions and adequate procedures for imposing them. Various legislative proposals have been introduced in Congress[15] or are in the process of being drafted.

---

[15]Congressman Roybal of California has introduced a bill to reform section 592. H.R. 11089, 94th Cong., 1st Sess. The bill states the basic offense generally in terms of section 592, except that no liability is incurred unless the United States is or may be deprived of lawful duties by the false or fraudulent action. The sanction for violation has been changed from forfeiture or an equivalent penalty to a penalty stated in terms of a percentage of the underpayment of duties. Where a violation occurred and the underpayment was due to negligence or unintentional disregard of customs laws and regulations without intent to defraud, a penalty duty of 5% of the underpayment would be assessed on the merchandise. If the underpayment were due to fraud, there would be assessed on the merchandise a penalty duty equal to 50% of the underpayment of duties. These percentages are based on the income tax penalty provisions contained at 26 U.S.C. § 6653. The bill also would permit Customs to assess duties equal to the amount of the underpayment of lawful duties, in addition to the penalty duties. The penalties and additional duties could be remitted or mitigated in whole or in part by the Secretary of the Treasury pursuant to § 1618. In addition to the above substantive changes, the bill would specifically provide for judicial review of the Secretary's determinations by the Customs Court. Within 60 days after notice of receipt of a final determination of the Secretary of the Treasury upon a petition for remission or mitigation, the petitioner could file a request for judicial review with the United States Customs Court. The court would have jurisdiction to review the entire matter in a trial *de novo*, and payment of any penalties and additional duties assessed by Treasury would be stayed during the pendency of the Customs Court proceedings.

While the Roybal bill is a great improvement over the existing section 592, still there are various criticisms that can be made of it. First, the bill does not state the offense as clearly as it might. Basically, the bill accepts the wording of section 592, to which are added additional subparagraphs distinguishing negligence cases from cases of fraud. Second, the bill continues to make the penalty applicable to the merchandise, rather than to the person committing the offense. Accordingly, an innocent consignee might still suffer the penalty on account of fraud committed by the shipper. Third, while the bill would revise section 592, it does not make comparable changes in the criminal provisions of 18 U.S.C. § 542. The bill would make loss or potential loss of revenues a requirement for imposition of a penalty duty, yet a person could still be found guilty under section 542 whether or not the fraud or false statement resulted in any loss of revenues. Fourth, the Customs Service probably would regard the amount of penalty duties that could be imposed under the bill for intentional fraud to be too low to have substantial deterrent effect. Fifth, the procedural emphasis in the bill is on judicial review, with

In August 1975 the House of Delegates of the American Bar Association called for legislative reform of section 592 in the following resolution:

> BE IT RESOLVED, that the American Bar Association recommends that Congress adopt legislation reforming Section 592 of the Tariff Act of 1930, 19 U.S.C. § 1592, in the following respects.
>
> 1. By providing for civil penalties against the person violating the statute rather than for forfeiture of goods involved;
>
> 2. By providing that such penalty shall be a reasonable amount in light of the culpability of the violator and the consequences of the violation;
>
> 3. By providing reasonable informal administrative procedures by the Customs Service, including adequate notice and an opportunity to be heard prior to the assessment of a penalty;
>
> 4. By providing that the Customs Service must find a violation and assess a penalty on the basis of findings of fact and a statement of reasons; and
>
> 5. By providing trial by a court of all factual and legal questions relating to the issues of whether a violation occurred and the appropriate amount of the penalty.

Reform legislation along the lines suggested by this resolution would go far toward eliminating the problems of section 592.[16]

---

no effect to improve the fairness of the administrative determination. Placing principal emphasis on judicial review can make vindication of rights more expensive and can result in the Customs Court's being clogged with numerous small and unimportant cases in which it would have to conduct *de novo* trials.

[16]In drafting such legislation, and implementing regulations thereunder, it would be worthwhile to give attention to certain features of the civil penalty procedures followed by the Internal Revenue Service. These procedures combine the imposition of penalties which are reasonable in amount with a number of levels of informal administrative review providing notice and an opportunity to be heard. However, unless maximum customs penalties are to be held to the same proportionate levels as IRS penalties, the customs procedures should go beyond those of IRS and provide for a reasoned administrative decision based on findings of fact.